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E FOR THOMAS PIERCE,
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EX-IM BANK FOR MICHELE WILKINS
OPIC FOR GEORGE SCHULTZ AND RUTH ANN NICASTRI
PASS USTR FOR SUE CRONIN AND MARY SULLIVAN
TREASURY FOR ALICE FAIBISHENKO
USDOC FOR ALEXANDER PEACHER AND JOHN ANDERSEN
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E.O. 12958: N/A
TAGS: [ECON](#) [ENRG](#) [EPET](#) [AR](#)
SUBJECT: DUKE ENERGY BETS ON GROWING ARGENTINE ELECTRICITY
DEMAND, EVENTUAL REGULATORY NORMALIZATION

This cable contains U.S. company-specific commercially
sensitive information.

Summary

¶1. (SBU) Duke Energy plans to upgrade and expand its two hydro and gas-fired electricity generating plants in Neuquen province and possibly make new generating capacity acquisitions in the domestic market. In a call on Ambassador Wayne, Duke executives explained that they see the Argentine electricity market as a promising long term play, with growth potential superior to that of Duke's mature U.S. domestic electricity market. Duke takes this position in the face of an interventionalist Argentine regulatory regime in which the availability of natural gas to fire its combined cycle plant is not assured and in which the GoA-controlled energy wholesaler has shortchanged the company over \$25 million on hydro and gas electricity generation payments. Further, the GoA has forced Duke and other generators to convert this GoA debt into equity in a new GoA generating facility fiduciary fund. The GoA has promised to normalize its electricity market regulation beginning in 2008. End Summary

¶2. (U) Duke Energy Southern Cone COO Laine Powell and Argentina Country Manager Guillermo Fiad met with Ambassador

November 15 to review Duke's operations in Argentina and to discuss Duke's electricity generation investment strategy in Argentina, including its forced investment in GoA generation fiduciary funds, its plans to upgrade and expand existing Neuquen province hydro and gas-fired plants, and possible new generating sector acquisitions in the domestic market.

Duke Energy in Argentina

¶3. (U) Duke Energy Argentina, a subsidiary of Duke Energy International, owns two power generating assets in Neuquen province: The Planicie Banderita hydroelectric power station produces 476 MW and the Alto Valle gas-fired thermal station produces 80 MW. Duke also began conducting licensed trading and marketing in the wholesale electric and natural gas markets in late 2000.

¶4. (SBU) Powell noted that, to meet the company's global energy generation growth targets of 4-6% a year, Duke is looking to expand its presence in Argentina, Central America, Peru and Brazil. As a result, in recent discussions with Planning Minister De Vido, Duke committed to upgrade its Alto Valle gas-fired plant to bring 17 MW of unused capacity on line. In return, Duke asked De Vido to commit to lock-in scarce natural gas supplies for this plant. Duke has also submitted to Energy Secretary Cameron plans to invest roughly \$60 million to add 37MW of new generating turbines to its Neuquen hydro plant if an appropriate package of federal and provincial tax incentives can be negotiated. Powell noted that, given his company's positive view on long term local market development prospects, Duke is exploring new generation acquisitions in Argentina. The company's strategy is to purchase existing single cycle gas-fired generation plants and upgrade them to combined cycle operations (where significant efficiency gains are realized by capturing waste heat).

Duke's Strategy: A Non-Confrontational Stance

¶5. (SBU) Unlike a number of other U.S. energy sector players here, including CMS Energy, Duke did not file an ICSID claim seeking compensation for the (1) pre-emergency law de-linking of power tariffs from the U.S. producer price index; and (2) post-emergency law pesification of generation capacity cost and variable cost payments by regulated electricity wholesaler CAMMESA. (Note: Pre-crisis capacity payments to generators were roughly US\$10/MW while current payments total roughly \$4/MW). Country Manager Fiad called this the right decision for a company that sees long term growth opportunities in the Argentine energy market.

Forced Fiduciary Fund Investment

¶6. (U) With voluntary private investment in new electricity generating capacity limited by GoA price controls and investor concerns over rapid GoA shifts in sector regulation, the GoA created a fiduciary fund, FONINVENMEM (Fondo de Inversiones en Mercado Electrico Mayorista - Fund for Investment in the Wholesale Electricity Market) to force new investment by generators in two new 800 MW combined cycle plants in Buenos Aires and Santa Fe provinces. The plants will cost USD 1.2 billion, of which USD 450 million is being funded by the forced swap of outstanding CAMMESA debt to generators into FONIMVENMEM equity. This debt results from longstanding shortfalls in required marginal cost CAMMESSA payments to generators. The GoA has stated that the remaining \$750 million would be funded via a 3-4% surcharge on medium and large electricity users over the next 5 years, via private pension fund financing and via new investors.

¶7. (U) Generators, share of forced FONINVENMEM investment is based on their share of domestic generating capacity.

Duke,s share of the USD 450 million generators,
"investment" is 5%. France,s Total (which just announced the
sale of its Argentine generating assets to a local group and
to Merrill Lynch) holds 28%, Spain,s Endessa holds 23%, AES
holds 15% and Petrobras holds roughly 10%. In exchange for
this forced investment, the GoA has committed to (1) have
energy wholesaler CAMMESA sign a power purchase agreement to
guaranty the profitability of the two new plants; (2) secure
dedicated gas supplies to supply the new plants; and (3)
eventually transition to a free market in energy tariffs
after the two new plants come on line in 2008.

Comment

¶8. (SBU) While Duke executives acknowledge the many
inefficiencies, uncertainties and electricity production
risks inherent in the GoA's interventionalist approach to
managing Argentina's energy sector, they continue to see the
Argentine market as one with promising medium term prospects.
A legacy of major energy sector investment in the 1990s has
left Argentina with a relatively modern electricity
generation, transmission and distribution infrastructure.
Populist post-2002 crisis GoA policies have kept consumer and
industrial end-use electricity prices far below world market
levels. Not surprisingly, this has led to significant
increases in electricity demand. Argentina's national grid
is now reaching the limit of its capacity and new generating
facilities are desperately needed. Despite regulatory
uncertainty, Duke is betting this looming shortage spells
opportunity. End Comment
WAYNE